

Message Text

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TAGS: OVIP (KISSINGER)

SUBJECT: PRESS MATERIAL

PLEASE PASS RODMAN/ADAMS/BORG FOR SECRETARY KISSINGER

1. HERewith FREDERIC W. HICKMAN COLUMN, MARCH 18, WASH POST, ENTITLED "REDUCING OIL IMPORTS: QUOTAS VS. TAXES."

2. THE ARGUMENT OVER REDUCING OIL IMPORTS HAS RECENTLY FOCUSED ON COMPARING THE PRESIDENT'S PROPOSALS WITH A SYSTEM OF QUOTAS ON THE AMOUNT OF OIL THAT MAY BE IMPORTED. MANY ADVOCATES OF A QUOTA SYSTEM -- INCLUDING THE POST IN A RECENT EDITORIAL -- SEEM UNAWARE OF THE EFFECT OF A QUOTA SYSTEM ON THE PRICE OF OIL.

3. BOTH THE PRESIDENT'S PROPOSALS AND A QUOTA SYSTEM WOULD REDUCE THE CONSUMPTION OF OIL. A QUOTA SYSTEM WOULD REDUCE THE QUANTITY OF OIL PHYSICALLY AVAILABLE.

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4. THE PRESIDENT'S PROPOSALS WOULD RAISE THE PRICE OF OIL

RELATIVE TO OTHER COMMODITIES BY IMPOSING AN IMPORT FEE AND BY REMOVING THE CONTROLS THAT EXIST ON 40 PER CENT OF THE OIL WE CONSUME. THE AMOUNT BY WHICH OIL PRICES INCREASE WOULD BE COLLECTED FROM IMPORTERS AND PRODUCERS BY ADDITIONAL TAXES AND RETURNED TO CONSUMERS IN THE FORM OF INCOME TAX REDUCTIONS. CONSUMPTION WOULD FALL BECAUSE CONSUMERS WOULD

NOT SPEND ALL OF THEIR ADDITIONAL TAKE-HOME PAY ON HIGHER PRICED OIL.

5. THE LOUDEST OBJECTIONS TO THE PRESIDENT'S PROPOSALS CENTER ON THE FACT THAT OIL PRICES WOULD RISE. THOSE OBJECTIONS PERSIST NOTWITHSTANDING THAT CONSUMERS WOULD BE MADE WHOLE BY TAX REDUCTIONS.

6. SOMEHOW, THE NOTION HAS CREPT INTO THE PUBLIC DEBATE THAT PRICE INCREASES COULD BE AVOIDED WITH A QUOTA. THAT IS NOT SO. A QUOTA THAT RESTRICTS IMPORTS WILL REDUCE THE QUANTITY OF OIL AVAILABLE. WHEN THE SUPPLY OF AN ITEM IS REDUCED, THE PRICE RISES.

7. IF A QUOTA WERE TO CUT IMPORTS BY 1 MILLION BARRELS A DAY, THE SUPPLY OF OIL WOULD DROP TO ABOUT 15.5 MILLION BARRELS A DAY, AND TREASURY ECONOMISTS ESTIMATE THAT THE AVERAGE PRICE OF OIL IN THE UNITED STATES WOULD THEN RISE ABOUT \$4 A BARREL, OR 10 CENTS A GALLON, TO A NEW AVERAGE PRICE OF ABOUT \$13. THAT ESTIMATE IS BASED ON WHAT ECONOMISTS CALL PRICE "ELASTICITIES," WHICH MEASURE THE WAY PEOPLE RESPOND TO CHANGES IN THE PRICE OF OIL.

8. THE PRESIDENT'S ENERGY PROPOSALS WOULD REACH THE SAME RESULT, BUT WOULD GET THERE FROM THE OPPOSITE DIRECTION -- BY INCREASING THE PRICE OF OIL, RATHER THAN BY REDUCING THE QUANTITY SUPPLIED. HOWEVER, THE SAME 10 CENTS A GALLON WOULD PRODUCE THE SAME REDUCTION OF 1 MILLION BARRELS A DAY. THAT IS BECAUSE, AT ANY GIVEN PRICE, THERE EXISTS SOME GIVEN QUANTITY OF OIL THAT PEOPLE WILL BUY. IF IT ULTIMATELY TURNS OUT THAT PEOPLE WILL BUY 15.5 MILLION BARRELS OF OIL AT A PRICE 10 CENTS A GALLON ABOVE THE PRESENT PRICE, IT MAKES NO DIFFERENCE WHETHER ONE

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GETS TO THAT RESULT BY CHANGING THE PRICE OR BY CHANGING THE QUANTITY.

9. THE CATCH IS THAT WE DON'T KNOW -- IN ADVANCE -- JUST WHAT QUANTITIES PEOPLE WILL ULTIMATELY BUY AT A PARTICULAR PRICE BECAUSE THE ELASTICITY DATA ARE ONLY ESTIMATES. THUS, BOTH APPROACHES INVOLVE ELEMENTS OF UNCERTAINTY. WITH A QUOTA APPROACH, THE REDUCTION IN QUANTITIES WOULD

BE KNOWN IN ADVANCE, BUT THERE WOULD BE SOME UNCERTAINTY ABOUT THE AMOUNT OF PRICE INCREASES.

10. THE PRESIDENT'S PROPOSALS, UNLIKE A QUOTA, HAVE THE ADVANTAGE THAT ONE KNOWS IN ADVANCE WHAT THE PRICE CHANGES WILL BE AND THEREBY AVOID PRICE UNCERTAINTY, WHICH CAUSES GENERAL DISLOCATIONS AND HARDSHIPS. CHANGES IN IMPORT LEVELS ARE MERE ABSTRACTIONS TO MOST INDIVIDUALS UNTIL

THEY ARE TRANSLATED INTO PRICE DATA THAT ENTER INTO FAMILY BUDGETS AND BUSINESS DECISIONS. FOR A COMPANY ASSESSING THE RISKS OF GOING INTO THE OIL-SHALE BUSINESS, FOR EXAMPLE, THE CRITICAL DATA ARE OIL PRICES.

11. THE FACT THAT QUOTAS, UNLIKE THE PRESIDENT'S PROPOSALS, WOULD PERMIT US TO PREDICT IMPORT REDUCTIONS PRECISELY IS NOT IMPORTANT. WE DO NOT NEED TO KNOW THE EXACT AMOUNT BY WHICH IMPORTS WILL BE REDUCED IN THE FIRST YEAR. IT IS ENOUGH TO KNOW THAT WE ARE MOVING IN THE RIGHT DIRECTION AND WITH ESTIMATES THAT WILL BE ROUGHLY CORRECT OVER A PERIOD OF SEVERAL YEARS. IF IT TURNS OUT THAT OIL CONSUMPTION DOES NOT DECLINE RAPIDLY ENOUGH, ADJUSTMENTS CAN BE MADE.

12. A MAJOR DISADVANTAGE OF A QUOTA IS THAT IT WOULD CAUSE THE PRICE OF UNCONTROLLED OIL TO INCREASE UNCONSCIONABLY IF COMBINED WITH OUR PRESENT TWO-TIER OIL PRICE SYSTEM. ALL OF THE PRICE INCREASE CAUSED BY A QUOTA WOULD BE ON THE TWO-THIRDS OF TOTAL CONSUMPTION THAT IS UNCONTROLLED. A 1 MILLION BARREL A DAY REDUCTION BY QUOTAS WOULD CAUSE THE PRICE OF UNCONTROLLED OIL TO RISE FROM THE PRESENT \$11 TO ABOUT \$18 -- A TOTALLY UNJUSTIFIABLE PRICE INCREASE FOR THE OWNERS OF SUCH OIL.

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13. ALSO, A FUNDAMENTAL DEFECT OF A QUOTA IS THAT THE PRICE INCREASES IT CAUSES REMAIN IN THE HANDS OF PRODUCERS AND IMPORTERS, WHILE THE PRESIDENT'S PROPOSALS, ON THE OTHER HAND, WOULD RECHANNEL PRICE INCREASES TO THE GOVERNMENT AND THENCE BACK TO CONSUMERS. IN ORDER TO MINIMIZE THIS DEFECT IN THE CASE OF IMPORTS, SOME PROPOSE THAT A GOVERNMENT BUYING AGENCY TAKE OVER THE IMPORT FUNCTIONS NOW PERFORMED BY AN ELABORATE NETWORK OF THOUSANDS OF BROKERS, DEALERS AND USERS, WHO RISK THEIR OWN MONEY TRYING TO BUY AT THE CHEAPEST PRICE POSSIBLE. NO ONE HAS YET POINTED TO THE GOVERNMENT AGENCY WHOSE RECORD JUSTIFIES THE BELIEF THAT A BUREAUCRACY WOULD PERFORM THIS FUNCTION BETTER. IN ANY EVENT, THE QUOTA-INDUCED PRICE INCREASES ON DOMESTIC PRODUCTION WOULD STILL BE IN PRIVATE HANDS.

14. ANOTHER SUGGESTION TO RECHANNEL HIGHER PRICES ON IMPORTS FROM PRIVATE IMPORTERS TO THE GOVERNMENT IS A SYSTEM UNDER WHICH THE GOVERNMENT WOULD PERIODICALLY AUCTION QUOTAS TO THE HIGHEST BIDDERS. THAT WOULD AVOID CREATING VESTED INTERESTS, BUT IT WOULD NOT RECAPTURE THE QUOTA-INDUCED PRICE INCREASES GOING TO DOMESTIC PRODUCERS, AND IT WOULD GREATLY COMPLICATE THE OPERATIONS OF BUSINESSES THAT RELY ON OIL AND OIL PRODUCTS. WITH PERIODIC AUCTIONS, COMPANIES REQUIRING LONG-TERM SUPPLY COMMITMENTS WOULD BE UNSURE OF THEIR COSTS AND A WHOLE NEW SYSTEM OF FUTURES MARKETS IN

IMPORTS QUOTAS WOULD HAVE TO BE DEVELOPED TO DEAL WITH THESE RISKS. EVEN A QUOTA THAT WAS LARGELY WINDOW DRESSING WOULD CREATE THE LATTER PROBLEM.

15. IT IS SOMETIMES ARGUED THAT A QUOTA IS PREFERABLE TO PRICE MECHANISMS BECAUSE IT COULD BE VARIED OR PHASED IN. HOWEVER, THAT IS EQUALLY TRUE OF THE PRICE MECHANISMS IN THE PRESIDENT'S PROPOSALS.

16. IN SUM, A QUOTA SYSTEM DOES NOT AVOID PRICE INCREASES; IT LEAVES ALL OR MOST OF THOSE INCREASES IN THE HANDS OF IMPORTERS AND PRODUCERS; AND IT REQUIRES ADDITIONAL BUREAUCRACY AND BUSINESS INEFFICIENCIES. IN CONTRAST, THE PRESIDENT'S PROPOSALS CHANNEL THE INCREASES TO THE GOVERNMENT FOR REDISTRIBUTION TO CONSUMERS AND LEAVE THE EXISTING UNCLASSIFIED

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COMPETITIVE MARKETS UNIMPAIRED. (END TEXT.) INGERSOLL

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